producers. By waiting until 1985 to impose the tax, the government might lose the short-run opportunity of passing on a larger share of the tax to foreign suppliers, since the market could be tighter by then.

The advantages of imposing an energy tax now may be outweighed by its effect on economic recovery. However, an energy tax would probably do less to impair recovery than an income tax increase of the same size, since part of the energy tax would initially be absorbed by foreign oil producers. If an energy tax was intended to provide revenues on a long-term basis, it should probably be an ad valorem tax. A tax fixed in terms of dollars per barrel of oil would tend to fall as a percentage of GNP as prices rose over time.

Tax Treatment of Health Insurance Premiums

The Administration proposes that, effective January 1, 1984, employees be required to include in their taxable income employer-paid health insurance premiums in excess of $175 per month for family plans and $70 per month for single plans. Employer-paid premiums established in collective bargaining agreements would be exempted until expiration of the agreements, but no longer than the end of 1985. The maximum amount not subject to tax would be raised each year by the rate of increase of the Consumer Price Index for wage earners (CPI-W).

The CBO and the Administration both estimate that this proposal would bring in $1.7 billion in additional income tax revenue and $0.6 billion in additional payroll tax revenue in 1984, rising to $10.7 billion from both sources combined by 1988 (see Table III-3). The estimate includes the effects of temporarily exempting union contracts, which reduces income tax revenue by $0.4 billion and payroll tax revenue by $0.1 billion in 1984. These estimates assume adoption of the recommendations of the National Commission on Social Security Reform; payroll tax revenue would be about $30 million lower in the absence of this assumption.

Taxing employer-paid health insurance premiums as proposed would affect about 20 percent of all households in 1984, if there were no exemptions. The delayed coverage of union contracts would reduce the number of households affected in that year, but an increasing percentage of households would be affected in years after that, because premiums are expected to rise more rapidly than the ceiling. In 1984, affected households with incomes between $10,001 and $15,000 would pay an average of $193 in additional taxes, and affected households with incomes between $50,001 and $100,000 would pay $371.

The revenue gain could be increased by lowering the amount of employer-paid premium that is excluded from tax. For example, taxing employer payments for health insurance that exceed $150 per month for family coverage and $60 per month for single coverage would yield $0.7 billion more in income tax revenue and $0.3 billion more in payroll tax revenue in 1984 than the Administration proposal. The ceiling could be lowered even further if more revenue was desired, but continued exclusion of some minimum level of employer-paid health insurance premium might be advisable to encourage provision of a basic set of health benefits by employers.

Both tax-policy and health-policy arguments have been made for taxation of employer-paid health insurance premiums. Exclusion of employer-paid premiums benefits persons with higher incomes, both because they tend to have larger employer-paid health insurance premiums and because they are in higher marginal tax brackets. The average 1983 tax benefit for all households with incomes between $10,001 and $15,000 per year is estimated to be $83, while that for all households with incomes between $50,001 and $100,000 is estimated to be $622. 2/ Moreover, the exclusion leads to what many consider to be overly extensive health coverage, which has expanded use of health care services unnecessarily and driven up their prices.

Opponents of taxing any portion of employer-paid health insurance argue that present health insurance coverage is not excessive and that changing the current policy would result in less insurance coverage; this might, in turn, cause some people to forgo needed medical care. Also, they argue that a uniform ceiling would have uneven effects, since a given employer contribution purchases differing levels of coverage depending on several factors, such as the regional and demographic characteristics of the work force.

Jobs Tax Credit for the Long-Term Unemployed

The Administration proposes to extend the Federal Supplemental Compensation (FSC) program and to modify it by adding a tax credit for new employers of FSC recipients. The credit could be applied against either the employer's Unemployment Insurance (UI) payroll tax or his federal income tax, with the employer's wage and salary expense deduction reduced by the

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2. Congressional Budget Office, Controlling Medical Care Costs Through Market Forces (May 1982), p. 27.

amount of the credit. The tax credit would be available as a series of vouchers issued to eligible recipients, and would be equal to one-half of the person's weekly FSC benefit for each week of new employment, up to the amount of the recipient's FSC entitlement. The average FSC benefit currently is about $120 per week, and benefits are paid for up to 16 weeks; the average credit would thus be about $60 per week for up to 32 weeks. Although the Administration's proposal calls for FSC cash benefits to be provided only through September 30, 1983, the voucher program would continue until April 1, 1984. After September 30, individuals who would have qualified for cash benefits if that part of the program had continued would continue to be eligible for vouchers in equivalent amounts. As long as the individual was hired before April 1, 1984, the employer would still be eligible for the credit. The proposal is estimated to reduce revenues by $0.2 billion a year in 1984 and 1985, and by smaller amounts from 1986-1988 (see Table III-3).

Use of a voucher system based on FSC would allow targeting of this employment stimulus on certain long-term jobless persons with substantial work histories. Assistance to these UI recipients, however, could come at the expense of other jobless persons who would not be eligible to receive the wage subsidy. This could occur either because workers with vouchers would be hired instead of other jobless persons when employment expanded, or because workers with vouchers would be hired to replace other employees. In addition, because UI recipients often have considerable work experience, they might later return to their previous jobs or take better jobs when they became available, having used the voucher only to obtain interim employment. Even this interim employment might be better for both the worker and the government than continued unemployment, however.

An existing employment tax credit--the Targeted Jobs Tax Credit (TJTC)--also provides income tax reductions for some employers who hire certain jobless persons. The potential amount of the TJTC tax reduction--$3,000 in the first year and $1,500 in the second--is larger than that in the new tax credit proposed by the Administration, which would average out to less than $2,000 for one year ($60 per week for 32 weeks = $1,920). 3/ However, the target groups served by the TJTC include primarily unskilled workers whose value to an employer may be less than that of the more experienced FSC recipients, so that a smaller tax credit might be appropriate. Nonetheless, the TJTC has not been very effective in stimulating

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3. This does not take into account in either case the requirement that the employer's deduction for wage and salary expenses be reduced by the amount of the credit, which reduces the amount of the tax savings.

employment, and larger tax reductions might be necessary to generate program use by large numbers of employers. The Administration's tax credit proposal could potentially be used by more employers, however, because UI payroll tax payments are made by nearly all employers, while many do not have sufficient income to owe income taxes.

Because the voucher program would be new and unfamiliar, there is some question whether it could be fully implemented by its scheduled April 1, 1983, starting date, even if the enabling legislation were passed quickly. Further, employers and those who administer it may be reluctant to gear up fully to use a program that is scheduled to last for only one year. In the case of the TJTC, it took several months before the availability of the credit was known to many employers, and even longer before they started to use it.

A problem inherent in the use of employment tax credits is that the persons responsible for hiring in large firms are often not in close touch with those who prepare the tax returns. Thus, even if an employment tax credit could significantly reduce an employer's tax liability, it might not translate into increased hiring of eligible workers. Others have proposed that the employment stimulus be in the form of a direct cash grant that could be more closely associated with the hiring process. This could increase use of the stimulus while retaining the same cost per worker. As discussed at the end of this chapter in the section dealing with tax expenditures, certain adjustments have to be made to either the tax credit or the direct grant to make certain they are of equal value to the recipient and equal cost to the government.

Tax Incentives for Higher Education

To encourage saving for college education expenses, the Administration is proposing to exempt from taxation the earnings of special education accounts. Under the proposal, a separate account could be set up for each dependent child, and contributions would be permitted up to $1,000 per child per year for children under 18 years of age. The $1,000 contribution limit would decline for contributors with adjusted gross incomes above $40,000 and reach zero for those with incomes of $60,000 and above. The account must be used for payments directly to a university or college for tuition, room, or board; it must be for study toward an undergraduate degree; and it must be spent before the student reaches age 25. If the account meets these conditions, its interest earnings would never be taxed.

The main revenue loss from these education savings accounts (ESAs) lies in the future. The Administration estimates negligible revenue losses in

1984 and only $0.4 billion in 1988. However, the annual revenue losses can be expected to grow rapidly for the first 10 to 20 years as savings accumulate in these accounts. The delay of revenue losses is advantageous given the large deficits forecast for the near term, but the long-run losses need to be considered as well.

The ESA would offer a higher return than is now available to parents who save in their own accounts for their children's college education. For example, a typical family with a $30,000 income using an ESA could make an 18 percent smaller annual contribution to savings and still end up with the same amount after 18 years, assuming an 8 percent market interest rate.

Under existing law, parents can also use trusts or gifts to minors to set up savings accounts in their children's names. Earnings in these accounts are taxable to the child, and the child pays no tax until his or her interest earnings exceed the $1,000 personal exemption. With an 8 percent interest rate, the child could hold $12,500 before earning $1,000 in interest income. Trusts and gifts to minors are more flexible in their uses than ESAs, so many families may prefer to use them first. But with costs for many colleges well in excess of $12,500, families with the resources to save more than that per child could benefit from ESAs.

A number of bills have been proposed in the Congress that would provide tax-favored accounts for education. Compared to the Administration's proposal, most of them would allow greater flexibility in funding and spending, and also make the initial contribution tax deductible. This last feature means that a typical $30,000-a-year family contributing to one of these accounts would receive a tax saving in the year of the contribution equal to almost a quarter of the amount contributed; those in higher tax brackets would receive higher tax savings. The deduction for contributions would substantially increase the revenue loss compared to the Administration's proposal, particularly in the years immediately after enactment. The Congressional proposals eventually recoup a portion of the revenue loss by including the parents' contributions and the interest from the account in the taxable income of the offspring--for example, one-tenth of the amount yearly from ages 25 to 34. Even with this ten-year recapture, the revenue loss from the typical family's account is almost 80 percent larger than that under the Administration's proposal (or the equivalent tax reduction currently available through trusts or gifts).

Table III-5 compares alternative savings accounts for a typical family, assuming for purposes of the comparison a common goal of saving $1,000 by the time college starts. The family of four with $30,000 of income is assumed to open a college savings account at the birth of a child and to

make equal contributions annually for 18 years. The table shows that at an 8 percent interest rate the annual contribution necessary to reach $1,000 in the parents' taxable account is $30.02. In the Administration's ESA, the required contribution is $24.72, or 18 percent less; in the prototype Congressional ESA, it is $19.03 (taking into account the tax savings from the deduction).

TABLE III-5. THE COST OF SAVING $1,000 FOR COLLEGE FOR A TYPICAL FAMILY UNDER ALTERNATIVE TAX TREATMENTS (In dollars) a/

	Parent Taxable Savings b/	Trusts and Administration ESA b/	Prototype Congressional ESA b/
Annual Family Deposit	30.02	24.72	24.72
Annual Tax Saving from Deductibility of Deposit	---	---	5.69
Net Annual Outlay	30.02	24.72	19.03
Life-Time Subsidy (present value of forgone tax)	None	53.60	95.29

a. See text for family characteristics and savings period. Calculations assume 8 percent market interest rate and discount rate. Parents are in 23 percent tax bracket; child until 18 pays no tax and from ages 25 to 34 is in the 15 percent tax bracket.

b. Parent Taxable Savings receive no special tax reductions from current law. Trusts and Administration ESA have tax-exempt earnings. The prototype Congressional ESA has deductible contributions, tax-exempt earnings, and $100 per year added to child's taxable income from ages 25 to 34.

The bottom line of the table gives the lifetime subsidy from the forgone taxes per $1,000 of accumulated savings. The $53.60 subsidy for the Administration ESA comes entirely from forgone taxes on earnings. The larger subsidy on the prototype Congressional ESA includes an additional $57.56 loss from permitting contributions to be deducted, offset by a $15.87 gain from including the account in the child's income. The subsidy rises in each case with the family's marginal tax rate.

In terms of the overall tax structure, tax-favored savings accounts erode the base of the income tax, thereby requiring higher tax rates on income from other capital and from labor. These accounts can be viewed as a step toward a consumption tax because they exempt one more form of savings from tax. While a number of families might shift savings into such accounts, the net increase in saving would probably be small because eligibility and contribution limits are restrictive.

National Commission on Social Security Reform Proposals

The President's budget includes the outlay reduction and tax increase proposals of the National Commission on Social Security Reform. CBO's estimate of the 1984-1988 revenue increase is $50.4 billion, $5.6 billion less than the Administration's estimate, mainly because the CBO economic forecast assumes a somewhat lower level of wages and salaries in the 1986-1988 period (see Tables III-3 and III-6). 4/

Other Proposals

The Administration proposed several other tax policy changes, as listed in Table III-3. An increase in federal employee contributions to the civil service retirement fund would raise $1.2 billion in 1984 and greater amounts in subsequent years. CBO's estimate of the revenue gain from this proposal is higher than the Administration's by about $0.2 billion in 1985 and $0.7 billion in 1988 (see Table III-3). About one-quarter of the difference is due to CBO's higher pay raise assumptions from 1985 through 1988, and about three-quarters to differences between CBO and Administration assumptions about how new employees will be affected by changes in Civil Service Retirement and Social Security. The enterprise zone and tuition tax

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4. The CBO estimate shown in Table III-6 is somewhat lower than that appearing in Reducing the Deficit: Spending and Revenue Options (February 1983). The reason is that CBO now assumes, as does the Administration, that income tax revenues will be reduced as a result of the proposed increases in payroll taxes. (The employer share of the payroll tax increase is assumed to be passed on to employees in the form of lower wages, thereby reducing employee taxable incomes.) Further, CBO has reestimated the revenue gain from including all new federal employees in the system. These factors reduce the previous CBO estimate of the unified budget impact of the commission proposals by $6.0 billion over the 1984-1988 period.

TABLE III-6. ESTIMATES OF THE REVENUE EFFECTS OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM PROPOSALS
(By fiscal year, in billions of dollars)

Proposals	1984	1985	1986	1987	1988	Cumulative Five-Year Increase
Include All Non-Profit Institutions in the System a/	1.1	1.7	2.0	2.3	2.9	9.9
Income tax offset	-0.1	-0.2	-0.2	-0.3	-0.4	-1.2
Include All New Federal Employees in the System a/	0.1	0.2	0.3	0.5	0.6	1.7
Accelerate FICA/OASDI Tax Rate for Calendar Years 1984 and 1988	6.4	2.3	0.0	0.0	10.3	19.0
Income tax offset	-0.8	-0.1	0.0	0.0	-1.3	-2.2
Individual income tax credit for 1984 payroll tax increase	0.0	-4.3	0.0	0.0	0.0	-4.3
Raise the SECA/OASDI Tax Rate to the Combined Employer-Employee Rate a/	1.0	3.0	2.9	3.1	3.5	13.7
Income tax offset (deduction for half of tax)	-0.5	-1.5	-1.5	-1.6	-1.8	-6.8
Tax 50% of OASDI Benefits with Thresholds of $20,000 (single) & $25,000 (joint)	1.2	4.2	4.9	5.6	6.4	22.4
Total Increase in Social Security Trust Fund Revenues	9.7	11.5	10.1	11.5	23.7	66.6
Total Loss in Income Tax Revenues	-1.5	-6.1	-1.7	-1.9	-3.4	-14.6
Reduced Contributions to Civil Service Retirement b/	-0.1	-0.2	-0.3	-0.5	-0.6	-1.7
Total Increase in Unified Budget Revenues	8.2	5.2	8.1	9.2	19.7	50.4

a. Estimates include proposed increase in OASDI payroll tax rates.

b. Assumes contributions of new federal employees to Social Security will result in commensurate reductions in contributions to civil service retirement.

credit proposals closely follow versions considered in the previous Congress. The Caribbean Basin initiative is limited to two narrow provisions and would have very limited revenue consequences.

BASELINE REVENUE ESTIMATES

The preceding sections have dealt only with the Administration's proposals for changes in the tax law. This section compares CBO's "baseline" estimates of revenues that would be raised under current law to the Administration's "current services" estimates. The two estimates are conceptually the same; they both assume that present airport and airway taxes will be extended at current rates beyond the scheduled expiration date of December 31, 1987, but that existing law will remain otherwise unchanged throughout the 1983-1988 period. All scheduled increases and reductions in taxes are assumed to go into effect as scheduled.

As shown in Table III-7, CBO's current law estimate for 1983--$606 billion--is almost $9 billion higher than the Administration's. CBO's estimate remains about $4 to $5 billion higher in 1984 and 1985, and then moves below the Administration's estimate by increasingly large amounts in 1986-1988, falling $44 billion below the Administration's $927 billion estimate in 1988. As shown in the table, most of the differences between CBO and the Administration in the early years of the projection period are due to technical differences in estimating procedures and assumptions, while most of those in the later years are due to different assumptions about the economy. All of the differences are relatively small, however--less than 1 percent of total revenues in three of the six years, and less than 5 percent in 1988, the year with the largest difference.

Different Economic Assumptions

As discussed in Chapter II, CBO's economic projections are somewhat different from the Administration's, with CBO assuming higher real growth in 1983-1985, and lower real growth in 1986-1988. These different assumptions about economic growth are reflected in the levels of taxable personal income and corporate profits--the major determinants of projected revenues--in the CBO and Administration economic projections (see Table III-8). The relationships are not exact in 1983-1985: CBO has slightly lower levels of taxable personal income in 1983 and 1984, although the wage and salary component is higher than the Administration's in each of the years, and CBO's corporate profits are slightly lower in 1983 and 1985. CBO assumes lower income levels than does the Administration in 1986-1988, corresponding to the pattern of GNP growth.

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TABLE III-7. CBO AND ADMINISTRATION ESTIMATES OF REVENUES UNDER EXISTING TAX LAW (By fiscal year, in billions of dollars)

	1983	1984	1985	1986	1987	1988
Administration Current Services Estimates a/	597.5	648.8	713.3	780.9	849.1	926.7
Sources of Reestimates						
Different economic assumptions	b/	2.0	3.9	-5.7	-18.8	-36.0
Technical differences	8.8	2.7	0.5	-1.4	-3.1	-8.3
CBO Baseline (Revised) a/	606.3	653.6	717.7	773.9	827.1	882.4
Addendum						
Administration Current Services Revenues as Percentage of Administration GNP	18.7	18.6	18.7	18.8	18.8	18.9
CBO Baseline Revenues as Percentage of CBO GNP	19.0	18.7	18.8	18.7	18.5	18.4

a. Assumes extension of airport and airway trust fund taxes in 1988; this adds $2.6 billion to 1988 revenues.

b. Less than $50 million.

The levels of taxable income and profits are not the only determinants of revenue estimates, of course. The assumed timing of tax collections has a significant effect, as do other technical aspects of the estimating procedures. These technical differences are discussed in general terms below. The most significant economic and technical differences in the major revenue sources are then discussed in more detail.

Technical Differences

CBO and the Administration use different procedures for estimating individual and corporate income taxes, windfall profit taxes, and several other taxes. For the most part, estimation procedures differ because CBO

TABLE III-8. ECONOMIC ASSUMPTIONS OF PARTICULAR IMPORTANCE FOR REVENUE ESTIMATES (Calendar year averages, in billions of dollars)

	1983	1984	1985	1986	1987	1988
Taxable Personal Income						
CBO	2,268	2,456	2,658	2,857	3,061	3,278
Administration	2,278	2,466	2,653	2,863	3,114	3,378
Wages and salaries component						
CBO	1,649	1,783	1,925	2,074	2,229	2,395
Administration	1,640	1,780	1,921	2,090	2,281	2,483
Corporate Profits Before Tax						
CBO	168	221	244	283	305	318
Administration	177	206	246	296	316	329
Domestic Refiners' Acquisition Cost of Crude Oil (in dollars per barrel)						
CBO	30.85	32.15	32.60	33.42	34.72	36.00
Administration	31.00	31.96	33.73	35.64	37.61	39.68

and the Department of the Treasury have different data and analytical tools available to them. CBO has emphasized close coordination of its economic forecasting and revenue estimating efforts, with detailed translation of revenue collections data into the type of data that is used for economic forecasting. Historical data on the relationships between trends in the economy and revenue collections can then be used more readily to project future relationships, thereby maximizing consistency between projections of federal government revenues and conditions in other sectors of the economy.

The Treasury Department, by contrast, is required to make detailed estimates of the effects on current tax collections of a wide variety of specific tax law changes. This requires a great deal of information on and analysis of tax collections within single years, with somewhat less emphasis on projections of changes in collections over time in response to changing economic conditions. There is also less opportunity for close coordination of Treasury revenue estimating efforts with Administration economic forecasting, since a number of agencies outside the Treasury participate in formulating the Administration economic projections. These differences in approach will continue to lead to differences between CBO and Administration revenue estimates, especially in the later years of the projection period when small differences in economic forecasts may begin to cumulate into larger differences in revenue estimates.

In addition to utilizing formal estimation procedures, both CBO and the Administration assess daily and monthly tax collections data as they are made available. Since actual tax liabilities cannot be observed, current tax collections may be consistent with a range of potential tax liabilities. This is especially true for individual and corporate income taxes, where variations in payment patterns occur frequently, even in the absence of significant legislated changes such as those recently enacted. Differing interpretations of recent tax payment patterns are reflected in CBO and Administration estimates of current-year revenues. The combinations of formal and informal data-analyzing procedures developed by CBO and by the Treasury Department generate revenue estimates that are generally close when common economic assumptions are used, but minor differences persist.

Economic and Technical Differences by Source

Differences between the CBO and Administration current law estimates by tax source due to different economic assumptions, as mentioned above, generally result in higher CBO revenues in 1983-1985, and lower CBO revenues from 1986-1988 (see Table III-9). Differences between current law estimates due to technical estimating differences also generally result in higher CBO revenues in 1983-1985 and lower revenues in 1986-1988 (see Table III-10). As discussed below, however, the reasons for these technical differences are varied.

Individual Income and Social Insurance Taxes. Individual income taxes and social insurance taxes and contributions are based directly on personal income. Taken together, these taxes accounted for over 80 percent of total federal revenues collected in fiscal year 1982.

TABLE III-9. CBO REVENUE REESTIMATES ATTRIBUTABLE TO ECONOMIC ASSUMPTIONS, BY SOURCE (By fiscal year, in billions of dollars)

Source	1983	1984	1985	1986	1987	1988
Individual Income Taxes	-0.9	-2.4	+0.3	+0.1	-7.2	-21.3
Corporate Income Taxes	-0.2	+3.8	+4.7	-0.5	-1.7	+0.5
Social Insurance Taxes and Contributions	+1.9	+0.9	+0.3	-2.1	-5.8	-10.2
Windfall Profit Taxes	-0.1	+0.7	-0.2	-1.8	-2.3	-2.8
Other	-0.7	-1.0	-1.1	-1.4	-1.9	-2.3
Total	a/	+2.0	+3.9	-5.7	-18.8	-36.0

NOTE: CBO estimates less Administration estimates.

a. Less than $50 million.

Individual income taxes depend primarily on the level of taxable personal income, the largest component of which is wages and salaries. Social insurance taxes and contributions, which are payroll taxes, depend primarily on the level of wages and salaries. Since the CBO wage and salary assumptions, following the pattern of its GNP assumptions, are higher than the Administration assumptions in 1983-1985 and lower thereafter (see Table III-8), CBO's estimates of social insurance taxes and contributions also follow this pattern (see Table III-9).

CBO estimates of the other component of taxable personal income, nonwage income, are enough below the Administration assumptions in 1983 and 1984 to put CBO's total taxable personal income below the Administration assumptions in these years. 5/ These lower CBO estimates of nonwage income do not affect social insurance estimates at all, but nonwage income

5. Nonwage taxable income comprises proprietors' income, personal interest income, personal dividend income, and rental income.

TABLE III-10. CBO REVENUE REESTIMATES ATTRIBUTABLE TO TECHNICAL ASSUMPTIONS, BY SOURCE (By fiscal year, in billions of dollars)

Source	1983	1984	1985	1986	1987	1988
Individual Income Taxes	+1.5	+1.5	-0.9	-2.3	-4.2	-9.5
Corporate Income Taxes	+5.2	a/	-0.3	-1.2	-1.1	-1.4
Social Insurance Taxes and Contributions	-0.1	-0.5	-0.2	-0.2	+0.1	+0.3
Windfall Profit Taxes	+0.7	+0.6	+1.1	+1.6	+2.1	+2.5
Other	+1.4	+1.1	+0.9	+0.7	a/	-0.3
Total	8.8	2.7	0.5	-1.4	-3.1	-8.3

NOTE: CBO estimates less Administration estimates.

a. Less than $50 million.

makes up over one-fourth of the base used to calculate individual income taxes. These lower levels of nonwage income tend to reduce the CBO estimates of individual income taxes below the Administration estimates in these earlier years, even though CBO wage and salary levels are slightly higher. By 1986-1988, CBO wage and salary levels are lower as well. The largest difference in personal income-based revenue estimates occurs in 1988 when the CBO's lower income path brings the CBO estimate of the total individual income and social insurance taxes slightly more than $31 billion below the Administration estimate (see Table III-9).

For the most part, technical differences between CBO and Administration estimates of individual income and social insurance taxes are quite small, both in absolute terms and relative to the total amount of revenues

raised (see Table III-10). However, for 1986-1988 CBO's estimation procedures lead to individual income tax estimates lower than the Administration's. The Administration projects a larger response of taxes to income growth in this period than it projects for 1984 and 1985, while CBO projects a stable pattern of response. Given the assumptions of moderate economic growth and moderate rates of inflation by both CBO and the Administration, relatively stable effective individual income tax rates seem more likely for 1986-1988 than rising ones.

Corporate Income Taxes. Corporate income taxes depend primarily on economic assumptions about corporate profits and the level of investment (which determines the amounts of depreciation deductions and investment tax credits available to reduce corporate taxes). CBO's corporate profit assumptions are higher than the Administration's in 1984 and lower by increasing amounts in 1985-1988. CBO expects business investment to grow more slowly than the Administration assumes, and to account for a smaller share of GNP in each year. CBO's lower levels of investment reinforce the effects of its higher profits in 1984, raising CBO's estimate of corporate tax collections above the Administration's in 1984 (and in 1985 because of the lags between corporate tax accruals and actual collections). In subsequent years the effects of the profit and investment assumptions are largely offsetting, with CBO's lower profits tending to pull tax collections down relative to the Administration, while its lower investment assumptions tend to push collections up.

The only large technical estimating difference between CBO and the Administration occurs in 1983. This difference, which puts the CBO estimate about $5 billion above the Administration's, results in part from the Administration's assumption that the high penalty interest rate imposed last year brought in an unusually large volume of "back taxes" that will reduce corporate income tax payments this year. CBO agrees that this is quite possible, but chooses not to include the assumption in its baseline estimates for 1983. Technical differences between the CBO and Administration corporate income tax estimates in other years are significant, but mostly offsetting.

Windfall Profit Taxes. In 1988, CBO projects an average domestic refiner acquisition cost of crude oil almost $4, or 9 percent, below the Administration's (see Table III-8). CBO's assumption of a lower oil price path beginning in 1985 reduces its estimates of windfall profit taxes below the Administration estimates by increasing amounts over the 1985-1988 period.

These differences in windfall profit tax estimates because of oil price assumptions are offset in part by a technical factor--CBO's assumption that some eligible tier-one oil will not be reclassified as lower-taxed incremental tertiary oil. This slower rate of reclassification is assumed to occur because, in certain circumstances, the cost to the producer of reclassifying is greater than the potential tax reduction.

Economic and technical differences between the CBO and Administration estimates of other tax sources are quite small, only about $1-2 billion per year, and mostly offsetting.

REDUCED SENSITIVITY OF REVENUES TO ECONOMIC GROWTH

The present tax structure has significantly reduced the sensitivity of revenues to different levels of economic growth. In July 1981, for example, before the Economic Recovery Tax Act of 1981 (ERTA) was enacted, CBO projected that current law revenues would increase from 21.4 percent of GNP in 1981 to 23.9 percent of GNP in 1986, using the optimistic economic assumptions of the first budget resolution for 1982. 6/ This year, by contrast, CBO's projection shows current law revenues dropping somewhat as a percentage of GNP over the 1983-1988 period under both the high- and low-growth alternatives to the baseline revenue projections. 7/

Thus, even though both CBO and the Administration are assuming moderate rates of economic growth that could conceivably be exceeded over the 1983-1988 period, the revenue share of GNP would not be sufficiently increased by any feasible overall economic performance to make a significant dent in projected budget deficits. There are two major reasons for this reduced sensitivity of revenues to changes in economic conditions:

- o Starting in 1985, the individual income tax exemptions and rate brackets will be indexed to the rate of inflation. As a result, real tax revenues will no longer increase solely because of increases in the price level; rather, they will increase only at a rate very slightly higher than the rate of real income growth. Therefore, individual

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6. Congressional Budget Office, Baseline Budget Projections: Fiscal Years 1982-1986 (July 1981), p. 10.

7. Congressional Budget Office, Baseline Budget Projections for Fiscal Years 1984-1988 (February 1983), p. 16.

income tax revenues will grow much more slowly relative to the size of the economy than they did in the late 1970s and early 1980s.

- o Corporate income tax revenues are now less sensitive to economic conditions because of the expansion of the investment tax credit and accelerated depreciation in ERTA. Economic upswings typically increase corporate profits more than in proportion to total income, but under the liberalized provisions of ERTA, capital cost recovery deductions and investment tax credits will increase at an even faster rate if investment shows its usual relationship to economic growth, and will provide greater tax reductions when inflation is moderate. As a result, corporate tax liabilities can be expected to grow more slowly than before as the economy recovers.

For these changes in the tax structure to be outweighed, yielding revenue growth comparable to recent experience as the economy expands, it would be necessary for major changes in the economy to occur that would increase taxable income as a share of GNP. Such changes are unlikely, however. There is little evidence to suggest that the nontaxable parts of GNP--primarily depreciation, employee fringe benefits, and indirect business taxes (mostly excise taxes)--will grow any more slowly than in recent years, and thus allow the taxable share of GNP to expand. Accordingly, the revenue outlook for the coming years under any given forecast of economic growth shows lower receipts than recent experience would suggest.

The effects of these two major structural changes in the tax system can be illustrated by calculating the revenue share of GNP that would result if economic growth over the 1983-1988 period were to produce:

- o Increases in taxable personal income each year higher than those experienced in all but one year during the entire post-World War II period (ranging from 13.3 to 13.5 percent per year);

- o Comparable increases in corporate profits (with the profits assumed to be paid out in dividends rather than used for investment, in order to maximize tax collections); and

- o No significant increase in inflation above the levels assumed by the Administration (to maximize the real growth share of personal income increases, and thus produce higher collections from an inflation-indexed income tax).

Even with these assumptions (which are unrealistic but are extremely favorable to revenue growth), revenues under existing law would rise to only

19.6 percent of GNP by 1988, only 1.2 percentage points above the 1988 CBO baseline share and only 0.7 percentage points above the Administration's 1988 current services share. In short, significant reduction in projected budget deficits from the tax side will require changes in current tax law.

TAX EXPENDITURES

As required by the 1974 Budget Act, the Administration's 1984 budget contains a list of current tax expenditures. Tax expenditures are revenue losses from provisions in the tax code that provide incentives for particular kinds of activities or that give selective tax relief to certain groups of taxpayers. Examples are the tax credit for the elderly, the partial exclusion of capital gains income, and the investment tax credit for certain types of equipment.

Although the process of defining which provisions in the tax code are normal and which are special--and therefore tax expenditures--is sometimes ambiguous, the annual lists of tax expenditures prepared by the Treasury and the lists prepared for the Congress by the Joint Committee on Taxation and the Congressional Budget Office have generally been in agreement. The tax expenditure budgets prepared by the Administration in 1982 and 1983, however, omit 13 provisions included in the most recent JCT/CBO listing (published March 8, 1982) and include one provision omitted from the JCT/CBO listing for definitional reasons. 8/ The Administration argues that the omitted provisions are not properly classified as tax expenditures. The largest omissions are those dealing with business depreciation.

In the Administration budgets submitted in 1982 and this year, the tax expenditure budget presented in Special Analysis G has included estimates of the "outlay equivalent" for each tax expenditure, as well as the usual revenue loss estimate. The outlay equivalent is the amount of direct outlay subsidy that would have to be provided to recipients in order for that subsidy to be equivalent in value to the subsidy provided through a given tax expenditure provision. The outlay equivalent is normally larger than the

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8. The provision included by the Administration but not by JCT/CBO was income of trusts to finance supplemental unemployment benefits under the "Exclusion of other employee benefits" heading. For a list of provisions not included by the Administration, see Congressional Budget Office, Tax Expenditures: Budget Control Options and Five-Year Budget Projections for Fiscal Years 1983-1987 (November 1982), p. 20.

revenue loss, since it is assumed that the recipient of an outlay subsidy would have to pay taxes on the amount of the direct subsidy. These taxes would reduce the value of the subsidy to the recipient. Most tax subsidies, by contrast, are not themselves subject to tax. The amount of the tax credit for home insulation, for example, is not treated as taxable income to the recipient, although a similar direct grant would be.

A tax subsidy can, in effect, be made subject to tax in a number of ways, thereby assuring that the tax subsidy and a taxable direct grant are equivalent. As is the case with the existing targeted jobs tax credit and the Administration's proposed jobs tax credit for the long-term unemployed, a tax credit could be made taxable by subtracting the amount of the credit from the amount the employer may deduct for wages paid. Similarly, the investment tax credit for machinery and equipment could be made equivalent to a taxable direct grant by reducing the amount of depreciation otherwise allowed by the amount of the credit (depreciation is now reduced by half the amount of the credit as a result of the Tax Equity and Fiscal Responsibility Act of 1982). Alternatively, a direct grant could be made equivalent to a nontaxable tax subsidy by increasing its size by the amount of tax that would be due on it, or explicitly exempting it from tax.

The outlay equivalent concept is most useful when the Congress is choosing between a tax subsidy and an alternative direct grant subsidy. When instead the choice is between keeping a tax subsidy or eliminating it, the usual revenue loss estimate is more relevant. Although the revenue loss estimates in the tax expenditure budget do not show the exact amount of revenue that would be gained if a provision was eliminated, since they do not take into account transitional effects, possible interactions with other parts of the tax code, and possible offsetting behavioral effects, they are a more reliable guide to the revenue cost of tax expenditures than are the outlay equivalent estimates.